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(50)

Public Citizen

Buyers Up • Congress Watch • Critical Mass • Global Trade Watch • Health Research Group • Litigation Group
Joan Claybrook, President

October 23, 2002

Mr. Michael Lesar
Chief, Rules Review and Directives Branch, Division of Administration Services
Office of Administration
U.S. Nuclear Regulatory Commission
Washington, DC 20555

Re: Comments on "white papers" submitted by Louisiana Energy Services to the NRC

Dear Mr. Lesar:

Public Citizen is appalled by the brazenness with which Louisiana Energy Services (LES) has submitted a series of "white papers" to the Nuclear Regulatory Commission (NRC), which call on the NRC to expedite its licensing process for the company's proposed uranium enrichment facility in Hartsville, Tennessee. We are equally disturbed by the NRC's apparent acquiescence to this series of contemptuous documents, which indicates to us that the NRC is not taking seriously its role as a regulator of the country's nuclear facilities.

If the NRC were to adhere to the grossly inappropriate requests by LES, it would further undermine the agency's already shaky integrity as a regulator of the nuclear industry and a protector of the public from the dangers of radiation. If LES applies for a license for this inappropriate project, the public deserves a thorough licensing process in which all controversial issues involved in the development of the proposed new, foreign-owned uranium enrichment facility are fully addressed.

In submitting these white papers, the managing officers of LES have demonstrated their contempt for the NRC licensing process, which has thwarted the company's effort to attain a license to build a similar uranium enrichment facility near Homer, Louisiana. Each of the memoranda is basically a request that the NRC lower the bar of its own licensing requirements and simply accept those suggested by LES! This defeats the entire purpose of a licensing hearing on this matter, because it essentially calls on the NRC to make a prejudgment on each of the issues that are problematic for LES in attaining this license. If the NRC were to concede to the requests of LES described in these documents, it would render itself entirely impotent in this licensing proceeding, and would fail to serve its function as a regulator of the nuclear industry and protector of the public from its potential harm. The NRC should have immediately dismissed the LES white papers as an entirely inappropriate attempt to hijack the licensing process. Instead, to our dismay, the NRC appears to be seriously considering the content of these white papers.

ERIDS-ADM-03
Template-ADM-013 add T. Johnson (TCJ)

Ralph Nader, Founder
215 Pennsylvania Ave SE • Washington, DC 20003-1155 • (202) 546-4996 • FAX: (202) 547-7392 • www.citizen.org

A closer inspection into the content of the white papers is very telling: it becomes clear that LES is seeking prejudgment in each of the issue areas that have caused it trouble in the past, or those issues which are potentially problematic. The submission of these memoranda is an overt attempt on the part of LES to evade public and government investigation, a necessary step in the licensing process that has proven overly burdensome and even fatal for LES in the past (for good reason).

This effort of an intending license applicant to manipulate the NRC licensing process is unacceptable. Moreover, as discussed below, the issues raised by LES in the white papers are themselves without merit. The NRC should summarily dismiss the LES white papers.

ISSUE 1: "ANALYSIS OF NEED AND NO ACTION ALTERNATIVE UNDER NEPA"

The first memorandum in the series of six white papers (which deal with the "policy issues associated with the licensing of a uranium enrichment facility"[1]) is a request that LES be exempt from a provision in the National Environmental Policy Act (NEPA) that requires the company to provide an "Analysis of Need" and an evaluation of the "No Action Alternative" as part of the Environmental Report (ER). The LES document states:

> ...[T]his memorandum sets forth the basis for the [U.S. Nuclear Regulatory] Commission to adopt a presumption that there is an established need for additional domestic uranium enrichment capacity, based upon Congressional policy pronouncements to this effect. Consistent with this, the "no action alternative" should require no further consideration by the applicant or the staff.

It being the case that the only uranium enrichment facility in the United States (operated by USEC) is currently operating nowhere near capacity, it is certainly a valid licensing requirement that a company proposing the development of a new uranium enrichment plant should establish that a need for such a plant exists, and perform an objective, exhaustive analysis of the "no action alternative." Public Citizen holds that there is no need for a new uranium enrichment plant in the United States.

Furthermore, to neglect the baseline "no action" assessment from NRC's licensing considerations would render the meaningless the NEPA requirement for a comparative evaluation of environmental impacts from this proposed agency action. It would be wholly inappropriate for NRC to side-step NEPA in this way.

ISSUE 2: "ENVIRONMENTAL JUSTICE"

The second issue dealt with in the LES white papers is "environmental justice." In this memorandum, LES brazenly lays forth six criteria that it recommends for adoption by the NRC as guidelines in its licensing hearings on environmental justice issues. It was on precisely these grounds that LES's license request to develop a uranium enrichment plant in Louisiana was

[1] This phrase serves as a header for each of the six "white papers" submitted by LES to the NRC.

derailed, and so it is not surprising that among these white papers there is a memorandum in which LES insists that the NRC establish strict guidelines on their consideration of environmental justice issues, which, if adopted, would, in effect, be a prejudgment in the favor of LES. There can be absolutely no justification for the NRC narrowing in this way the scope of licensing proceedings so as to minimize consideration of an issue on which LES knows itself to be vulnerable.

The company's officials betray their cavalier attitude toward environmental justice by focusing their complaint not on the substantive issues involved in considerations of environmental justice (issues on which LES has been found guilty of discrimination in previous licensing proceedings), but rather on the cumbersome hearings on the issue which have proved to be a burden for LES in the past. LES laments this crucial aspect of the judicial process in government licensing hearings, stating that "environmental justice contentions...require inordinate time and effort to resolve." Clearly, the concern of LES is not whether the siting of their plant is environmentally just or not, but rather how swiftly and easily the investigation by the NRC Licensing Board will proceed on this matter. The NRC should be offended by this affront to its duty to critically examine such issues of public concern.

The LES memorandum on environmental justice concludes with a list of six insolent recommendations on how it wants the NRC to conduct its hearings on environmental justice issues. The document states: "[W]e recommend that the Commission incorporate in an order the following criteria, so as to define the parameters of [environmental justice] issues that may be considered in any such proceeding." The memo goes on to list these criteria, which are clearly designed to result in a proceeding in which these very serious issues would be quickly resolved in the favor of LES. If the NRC were to willingly adopt these criteria in its licensing proceeding, it would abdicate its responsibility to conduct a fair, thorough hearing. Such an action would be perceived as a government regulator abandoning its duty by denying the public a fair hearing, and simply doing the bidding of the nuclear industry. In keeping with the Executive Order on Environmental Justice, Public Citizen urges the NRC to reject the LES recommendations and give full and thorough considerations to the disproportionate impact this and any NRC-licensed operation may have on poor or minority communities.

ISSUE 3: "FINANCIAL QUALIFICATIONS"

In the third of the six white papers, LES makes yet another audacious claim: that it may determine the proper parameters to be followed by the NRC in determining whether or not the company is financially qualified to build a uranium enrichment plant. Such a decision is solely within the jurisdiction of the NRC, and should clearly be made in the public interest. The suggestion that LES may define for itself the parameters used by the NRC in determining the company's financial qualifications is *prima facie* absurd. Of course LES would seek to exclude financial criteria that the company cannot meet, and if this arrangement were accepted by the NRC, the whole financial qualifications portion of the licensing hearing would be reduced to farce.

As evidence that such defined criteria are required in order that this licensing hearing may proceed expeditiously, LES cites its previous troubled licensing hearing with the NRC, which

lasted more than six years. To avoid this, LES proposes, guidelines must be established. Those guidelines, if adopted by the NRC, would establish the financial conditions required for NRC approval. The purview of these conditions is, presumably, within the scope of LES's financial capabilities and potential, and thus NRC adoption of these conditions would amount to a foregone conclusion that LES would be exempt from exhaustive scrutiny of financial qualifications during the licensing hearing.

This effort by LES to scuttle thorough NRC investigation of its financial qualifications during the licensing proceeding is particularly tasteless, given the spectacular collapse of Enron a year ago, subsequent and ongoing revelations of corporate accountability scandals, and the general instability of the energy industry at present.

[For more on the current instability in the energy industry, please see the attached copy and notice of a settlement agreement entered into by Duke Power and the Commission Staffs of the Public Service Commission of South Carolina and the North Carolina Utilities Commission, concerning an investigation into the questionable accounting practices of Duke Power. See also the attached copy of Public Citizen's July testimony before the Senate Committee on Commerce, Science and Transportation, Subcommittee on Consumer Affairs, Foreign Commerce and Tourism to further illustrate the need for strong financial review regulations.]

Public Citizen implores the NRC to ignore this request, and instead move to strengthen existing financial review requirements.

ISSUE 4: "ANTITRUST REVIEW"

The fourth issue dealt with in the LES white papers is whether or not the NRC ought to perform an antitrust review as part of the licensing hearing on the proposed uranium enrichment facility. Public Citizen contends that the NRC should do an antitrust review, given the size and multifarious operations of the partners involved in the LES venture, and the widespread corporate wrongdoing that currently plagues the energy industry, including several of the LES partners.

LES is an enormous consortium of energy companies seeking to monopolize the uranium enrichment industry in the U.S. The LES consortium is led by Urenco—itself a consortium of British, Dutch, and German government and corporate entities—and also includes the construction firm Fluor-Daniel and the energy industry giants Exelon Corp., Entergy Corp., Duke Energy (currently also under federal investigation for its energy trading practices), Westinghouse Electric Co., and Cameco Corp. Each of these companies has an interest in greater ownership of nuclear fuel chain, and this is why they have collectively formed LES, which exists solely for the purpose of developing a new domestic uranium enrichment facility. It is not in the interest of consumers of electricity to have this degree of consolidation in the energy industry, which enhances the power of corporations while eroding the capacity of government regulators to protect ratepayers.

Public Citizen maintains that it is imperative that the NRC perform an antitrust review in its licensing proceeding, so that this degree of consolidation in the energy industry may be more

thoroughly investigated, and the public may have the opportunity to comment on antitrust issues in this case.

ISSUE 5: "FOREIGN OWNERSHIP"

In the fifth memorandum, the issue of foreign ownership of a domestic uranium enrichment facility is addressed. Contrary to LES's arguments, the NRC's licensing regulations in 10 CFR 40.38 and 10 CFR 70.40 specifically name as ineligible any "Corporation [that] is owned, controlled, or dominated by an alien, a foreign corporation, or a foreign government." Of course, LES *is* owned, controlled, and dominated by foreign corporations and governments. (The consortium is led by Urenco—a consortium of British, and German government and corporate entities—which operates uranium enrichment facilities in Europe that employ the kind of gas centrifuge technology that would be applied in the proposed facility.) Despite the clear control of foreign-owned Urenco in this endeavor (its technological expertise in gaseous centrifuge uranium enrichment is essential to this venture), LES is seeking to skirt government investigation into this important matter by attempting to exploit statutory and procedural loopholes.

Statutory requirements also dictate that the NRC not issue a license that would be "inimical to the common defense and security or constitute an unreasonable risk to the health and safety of the public."[2] In view of this and the current context for national security concerns, the NRC should carefully and exhaustively examine, and subject to public scrutiny, the history of the foreign company Urenco, which has suffered severe security lapses in the past. In the 1990s it was revealed that a company expert had sold blueprints and parts for an advanced gas centrifuge to Iraq—technology that could be used in the development of nuclear weapons. Moreover, the NRC should take into consideration the broader foreign and domestic policy implications of granting a license to a foreign-dominated energy consortium to develop a domestic uranium enrichment facility. Such a move would be inconsistent with bipartisan efforts to move the country in the direction of energy independence.

ISSUE 6: "TAILS DISPOSITION"

This final memorandum in the series of white papers addresses the issue of the disposition of depleted uranium tails, which result from the uranium enrichment process. Depleted uranium is dangerous, long-lived radioactive waste, and LES is required, as part of its license application, to present a "plausible strategy" for the disposition of this waste. Rather than present any such strategy, LES argues that it is exempt from this provision because of a statute that requires the Department of Energy (DOE) to accept depleted uranium for disposal.

LES cites language from the USEC Privatization Act (an piece of legislation designed to release the USEC uranium enrichment facility from direct government ownership and control) as its "plausible strategy" for the disposal of depleted uranium tails:

> As part of [the USEC Privatization Act], Congress provided that the U.S. Secretary of Energy (hereafter, "DOE") "shall accept" depleted uranium for disposal upon the request of "any person licensed by the NRC to operate a uranium enrichment facility...under the

[2] Section 57 c., Atomic Energy Act of 1954.

> Atomic Energy Act." This provision was enacted for one specific purpose: to mandate that DOE dispose of depleted uranium...subject to two specific conditions: (1) the depleted uranium must be "ultimately determined to be low-level radioactive waste"... and (2) the generator of the tails must reimburse DOE for the cost of disposal...

The paper goes on to cite a 1991 SECY paper in which depleted uranium tails are unofficially and temporarily described as "low-level waste," simply for lack of a better, more precise classification. LES cites this document as a satisfactorily official statement of classification from the NRC, but the DOE, in a written response to the LES white papers (released by the NRC along with the LES white papers), disagrees:

> There has been no formal determination by NRC that depleted uranium is low-level radioactive waste for purposes of Section 3113 of the 1996 USEC Privatization Act. Consequently, the Department [of Energy] is not obligated to accept it for disposal unless and until NRC makes such a determination.

This is a very clear statement that LES is not, as it has argued, effectively exempt from providing the NRC with a plausible strategy for depleted uranium tails disposition. Even in the case that the NRC makes a policy pronouncement in which it classifies depleted uranium as "low-level waste," LES still should not be exempt from providing the NRC and the public with a statement describing a plausible strategy for the disposition of this dangerous, long-lived radioactive waste.

The disposition of depleted uranium is a very serious issue that has not been satisfactorily resolved. The uranium enrichment facilities at Oak Ridge, Tennessee; Paducah, Kentucky; and Portsmouth, Ohio have produced a total of 700,000 metric tons of depleted uranium over the past half-century. This waste now sits in some 50,000 steel cylinders, each weighing about thirteen tons, stacked in huge piles outside the enrichment plants, where it has the potential to enter into the environment through leaks in the cylinders. LES's attempt to merely hand off responsibility for this waste to the Department of Energy gives no assurance that the waste will not indefinitely linger in Hartsville, and does nothing to resolve the potential environmental, health, and security risks that this scenario poses. Indeed, the Department of Energy has a very tarnished record of nuclear waste management that has resulted in a legacy of cost-overruns, project mismanagement, and radiological contamination at other sites across the country. In short, relying on the DOE is not a plausible strategy for the disposition of this waste.

CONCLUSION

The NRC should summarily dismiss the LES white papers, and completely reject the requests for prejudgment on a number of important issues in the licensing hearing on the company's proposed uranium enrichment facility in Hartsville, Tennessee. It would be contrary to the public interest and an affront to the NRC's own licensing process if the Licensing Board were to accept the terms described in the LES white papers. Such an action by the NRC would also set a terrible precedent for future licensing proceedings, within and without the NRC, in which it might be considered acceptable for applicants to evade licensing scrutiny by submitting their own series of "white papers" that encourage the licensing body to essentially capitulate to industry interests.

The submission of these papers by LES, and the apparent acceptance of them by the NRC, reflects poorly on both entities: it appears that LES is attempting to hijack the licensing process, and the NRC seems to be acquiescing. The matters raised in the white papers are the most contentious and problematic issues that LES faces in achieving a license for this plant from the NRC, and they are the reason that LES had such a difficult time attaining a license for the plant that it wanted to build in Louisiana in the 1990s. Rather than face the friction that would arise in a fair licensing process in which the NRC thoroughly evaluated these issues and the public had ample opportunity to comment and intervene, LES is attempting to grease the skids of the licensing process, so that all of the decisions on these matters would have been effectively resolved—in LES's favor—by the time of the actual licensing proceeding. It is extremely disconcerting that the NRC seems to be relinquishing its role and duty as a regulator of the nuclear industry, instead capitulating to the demands of LES for a slick and easy licensing process. We sincerely hope that the NRC will retreat from this apparent tendency, and reject LES's request that the result of the licensing hearing be essentially a forgone conclusion.

Additionally, Public Citizen requests that the NRC extend the public comment period allowed in response to the LES white papers. The announced 30-day comment period is inadequate, given the breadth of issues dealt with in the white papers, the time required to access these documents for those without high-speed computers, the level of controversy surrounding this proposal, and LES's tarnished history of public relations. For any meaningful public participation to be possible, it is absolutely necessary that the NRC extend the comment period on these memoranda.

Public Citizen is a national, non-profit public interest organization that monitors nuclear energy issues. We are supported by 150,000 members across the country and work closely with local, regional, and national citizens' groups on issues of energy policy.

We hope that you will carefully consider and take into account our comments on this matter.

Sincerely,

Joseph P. Malherek
Policy Analyst,
Public Citizen's Critical Mass Energy and Environment Program

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

NEWS RELEASE

FOR RELEASE: October 22, 2002

For More Information, Contact: Chairman Jo Anne Sanford (919) 733-4249

NORTH CAROLINA UTILITIES COMMISSION AND SOUTH CAROLINA PUBLIC SERVICE COMMISSION RELEASE REPORT ON DUKE POWER ACCOUNTING REVIEW

In July 2001, the North Carolina Utilities Commission (NCUC) and the Public Service Commission of South Carolina (PSCSC) undertook a joint investigation regarding accounting practices at Duke Power, a division of Duke Energy Corporation (Duke Power). The accounting review was conducted by Grant Thornton LLP and the results were filed today with both state commissions, as was Duke Power's response. Grant Thornton's report and Duke's response agree in some respects and disagree in others.

In an effort to resolve these issues, the NCUC and PSCSC staffs and Duke Power negotiated a proposed settlement agreement, which was also filed today with both state commissions. This proposed settlement will be considered by the NCUC at its next Commission Staff Conference on Monday, October 28, 2002, and by the PSCSC at its next Commission Business Meeting on Tuesday, October 29, 2002. The NCUC Commission Staff Conference will begin at 10:00 a.m., in Room 2115 of the Dobbs Building, 430 North Salisbury Street, Raleigh, North Carolina.

The report prepared by Grant Thornton LLP, Duke Power's response, and the proposed settlement agreement can be accessed from the NCUC's website at www.ncuc.net under Docket Information, Selected Orders/Filings of Interest.

October 22, 2002

Geneva S. Thigpen
Chief Clerk
North Carolina Utilities Commission
4325 Mail Service Center
Raleigh, North Carolina 27699-4325

Dear Ms. Thigpen:

Re: Settlement Agreement - Independent Accounting Review of Duke Power by Grant Thornton LLP

Enclosed please find the original and 30 copies of a Settlement Agreement entered into by Duke Power and the Commission Staffs of the Public Service Commission of South Carolina and the North Carolina Utilities Commission.

This Settlement Agreement is submitted for approval by the North Carolina Utilities Commission. It will be presented to the Commission pursuant to an agenda item at the next Regular Commission Staff Conference on Monday, October 28, 2002.

Sincerely,

\s\ Robert H. Bennink, Jr.

Robert H. Bennink, Jr.
General Counsel

RHBjr

Enclosure

Settlement Agreement

WHEREAS, on September 5, 2001, the North Carolina Utilities Commission (NCUC) and the Public Service Commission of South Carolina ("PSCSC") announced a joint investigation of July, 2001 allegations regarding accounting irregularities at Duke Power, a division of Duke Energy Corporation ("Duke");

WHEREAS, the NCUC and PSCSC ("Commissions") announced that their joint investigation would continue in the form of an audit ("accounting review") of Duke conducted by an independent firm;

WHEREAS, the NCUC and PSCSC solicited independent firms to conduct the accounting review by way of a request for proposals that set forth the general guidelines and scope in a document entitled "Scope of Independent Audit of Duke Power," the terms of which are incorporated herein by reference and hereafter referred to as "accounting review;"

WHEREAS, the NCUC and PSCSC received competitive bids from independent firms to conduct the accounting review and pursuant to this process selected the accounting firm, Grant Thornton, LLP, to conduct the accounting review;

WHEREAS, Grant Thornton, LLP has completed its accounting review and has issued its report ("the GT report") to the NCUC and PSCSC;

WHEREAS, Duke has submitted its response to Grant Thornton, LLP's report to the NCUC and PSCSC; and

WHEREAS, the Staffs of the NCUC and PSCSC ("Commission Staffs") and Duke (hereafter referred to collectively as "the parties") desire to formally and positively resolve all matters within the scope of the accounting review without further controversy.

NOW, THEREFORE, the parties agree as follows:

1. The Commissions received Duke's August 28, 2001 report, the GT report filed October 22, 2002 and Duke's response filed October 22, 2002. The Commission Staffs believe that Duke's August 28, 2001 report addressed the matters within the scope of the Commissions' request at that time and that the accounting errors and issues described by Duke in its report were fully reviewed by Grant Thornton. The parties recognize that Duke and Grant Thornton are in agreement on certain issues; however, with regard to the accounting treatment for nuclear insurance distributions and certain other accounting issues addressed in the accounting review, the GT report and Duke disagree based upon assertions of differing professional opinions. Therefore, in order to conclude the accounting review process and to resolve and settle all matters resulting from and within the scope of

the accounting review, the parties agree to the terms of this Settlement Agreement. It is expressly understood and agreed that the acceptance of the terms and conditions of this Agreement is in full accord and satisfaction of and in compromise of a disputed matter, and that the execution of this Agreement by the Commission Staffs and Duke is not an admission with respect to any matters resulting from and within the scope of the accounting review, but made for the purpose of terminating a dispute.

2. Duke agrees that it will, no later than December 1, 2002, file for informational purposes the following state regulatory reports and a reconciliation, for the years 1998, 1999, 2000 and 2001, to reflect the impact of the recommended entries set forth in the GT report:

    - NCUC Quarterly ES-1 reports
    - PSCSC Quarterly reports
    - State specific pages of FERC Form 1 reports

3. The parties agree to financial and accounting terms that will generally require Duke: to restore in fiscal year 2002 the nuclear insurance reserve account to a level it would have reached had Duke not changed its accounting for nuclear insurance distributions in 1998; to correct in 2002 an erroneous 1998 accounting entry related to its Price Anderson Act nuclear liability reserve; and to make a one-time $25 million credit in 2002 to its deferred fuel accounts for the current benefit of North and South Carolina customers. These terms are more particularly described below:

    a. Duke agrees to credit the nuclear insurance distributions it received in 2001, in the amount of approximately $33.45 million, to Account 228.1 – Accumulated Provision for Property Insurance, an operating reserve account. Duke further agrees to credit $16.55 million of the nuclear insurance distributions from the amount of approximately $24.5 million which the company received in 2002, to Account 228.1, with the remaining amount of approximately $7.95 million to be recorded as a credit to Account 924 – Property Insurance. The NML portion of nuclear insurance distributions received by Duke in 2003 and subsequent years shall be credited to Account 228.1 and the remainder of any such distributions shall be credited to Account 924. All monies credited to Account 228.1 – Accumulated Provision for Property Insurance, an operating reserve account, shall be held for the benefit of ratepayers until the Company's next general rate cases in North and South Carolina, at which time the NCUC and PSCSC shall review the status and sufficiency of the account and shall determine the appropriate jurisdictional ratemaking treatment of all such funds, including all amounts then credited to Account 228.1.

b. Duke agrees to credit the amount of $1.75 million to Account 228.1 – Accumulated Provision for Property Insurance, an operating reserve account, and agrees to debit Account 421 – Miscellaneous Nonoperating Income (a below the line account) in order to remedy an incorrect 1998 accounting entry related to the Price Anderson Act.

c. Duke agrees to implement all of the remedial actions set forth by the Company in Paragraphs IV.b – IV.e of its August 28, 2001 Report to the NCUC and PSCSC.

d. Duke acknowledges and regrets that communications with the Commissions failed to adequately detail significant changes to prior accounting practices. In order to achieve full and complete resolution of all issues, whether disputed or agreed, within the scope of the accounting review, Duke agrees to record a one-time credit of $25 million to the deferred fuel accounts, Account 232.03 – Unbilled Fuel Revenues (North Carolina) in the amount of $18.75 million and Account 232.08 – Unbilled Fuel Revenues (South Carolina) in the amount of $6.25 million, for the benefit of North and South Carolina customers. These amounts will be incorporated into the next fuel clause proceedings in the respective states as an offset to fuel costs for the 12-month period established in the proceedings.

4. Duke agrees that the cost of Grant Thornton, LLP's (and its contractors') professional fees and expenses for the accounting review will be charged to its non-utility operations.

5. Having reached resolution of this matter, it is the intention of the parties to move forward in a positive fashion without further controversy.

6. The parties recommend that the Commissions approve the terms of this Settlement Agreement.

7. This Settlement Agreement shall be submitted for approval to the NCUC on October 28, 2002, and to the PSCSC on October 29, 2002. Each party reserves the right to withdraw this Settlement Agreement at any time prior to its approval. If the Settlement Agreement is not approved, or if it is modified or withdrawn, it is null and void by its terms and shall not be admissible in any subsequent proceeding.

This Settlement Agreement is final and conclusive.

DUKE ENERGY CORPORATION

By: \s\ Ellen T. Ruff
Ellen T. Ruff

Effective Date: October 22, 2002

Its: Senior Vice President Asset Management

NORTH CAROLINA UTILITIES
COMMISSION STAFF

By: \s\ Robert H. Bennink, Jr.
Robert H. Bennink, Jr.

Effective Date: October 22, 2002

Its: General Counsel

PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA STAFF

By: \s\ Gary E. Walsh
Gary E. Walsh

Effective Date: October 22, 2002

Its: Executive Director

Testimony of Joan Claybrook
President, Public Citizen
Before the Subcommittee on Consumer Affairs, Foreign Commerce and Tourism
U.S. Senate Committee on Commerce, Science and Transportation

July 18, 2002

The financial horror show that the American public has watched unfold across the corporate landscape over the past few months is nothing less than a corporate crime wave of epic proportions. We have seen the rise and fall of a new generation of robber barons, bearing striking resemblance – at least in greed and arrogance – to the Gilded Age executives of a century ago and to the corporate titans of the 1920s, when corruption in the boardrooms helped usher in the Great Depression. And to think it has been only a decade or so since taxpayers lost billions to the high-living thieves who raped the nation's savings-and-loan industry and drove it into the ground How soon we forget

We should not fall victim to the corporate apologists who would have us believe that this is the inevitable and natural consequence of the economic boom of the 1990s and that there are only a few bad apples involved. In fact, it is the opposite. We now are finding out that this speculative bubble grew larger and larger precisely because corporate executives were defrauding investors through accounting measures that hid the true nature of their profits and losses. And they had plenty of incentives to do so, because cozy board members, many with insider deals, granted them stock options and cheap loans that encouraged CEOs to cheat in order to run up stock prices in the short term so they could cash in.

These are not victimless crimes. The victims are policemen and firefighters, teachers, assembly line workers, mail carriers, secretaries and, yes, honest business men and women – the people who do the work of America, who live paycheck to paycheck and who fuel this economy with their work and their spending. The victims are the children whose college funds have evaporated, and the elderly, whose savings have been stolen

The American people are angry. And they should be. Since March 2000, when the stock markets peaked, investors have seen $7 trillion evaporate into thin air. That's an unfathomable number for most of us. But it means real pain for millions of Americans who have been encouraged to invest their savings. Spurred on by corporate and government policies that have reduced and in many cases eliminated the old system of guaranteed pensions – and even facing the possibility that Social Security as we know it will be phased out – Americans have entrusted their retirement savings to the stock market And now they find out the game has been rigged, and that they go broke while the crooks, who pay protection money to politicians, walk away with millions

This corporate crime wave is no accident. It is the result of a well-focused political drive over the past quarter century to remove government oversight of business practices and reduce or eliminate the accountability of corporations and their officers to investors and the public. Corporate America has campaigned with a full-scale attack on regulation – regulation of the financial securities markets and energy markets as well as the health, safety and environmental regulations that are designed to protect the public from death, injury and disease and ensure healthy, sustainable ecosystems, fisheries and wildlife.

Following the impressive citizen gains of the late 1960s and early 1970s – when Congress enacted a raft of new health, safety, environmental, consumer and civil rights protections – corporate America launched a cynical campaign to limit the government's power. This coordinated attack on citizen safeguards has been propelled by literally billions of dollars of shareholder money for political contributions, right-wing think tanks, lobbyists, smear campaigns, TV advertising and fake grassroots organizations. Both major political parties have seen a dramatic increase in contributions from big companies. Corporations have accounted for nearly 90 percent of all soft money contributions to the parties since 1995, according to the Center for Responsive Politics. Corporate soft money grew from $209 million in the 1996 cycle to $383 million in 2000. The corporate leaders who give shareholder money to politicians demand – and usually get – something in return for this political investment.

Corporate America's campaign of deceit portrays government regulation as inherently evil, as an unwarrranted intrusion into the free market system and as a drain on capital investment, profitability and U.S competitiveness. It also mocks and denigrates the judicial system, which punishes wrongdoing, imposes discipline on corporations when regulations fail, and allows injured parties to recover damages. According to corporate America's mythology, free markets can solve all our problems and government should just, as former President Reagan said, "get off our backs." Privatization of schools, Social Security, Medicare, water supplies and other commons are sought. This free market ideology, of course, does not extend to corporate welfare. The very corporations that sponsor this hypocritical campaign continue to feed at the public trough, using their political connections to obtain tax breaks, subsidies, inflated contracts and other government largess. This ideology is useful, it seems, only when it lines the pockets of those preaching it.

This campaign by big business has severely distorted government's purpose and its functions. Enforcement budgets have been slashed. Health, safety and environmental protection rules have been sacrificed to the altar of self-regulation and an unfounded trust in corporate leaders. Congress and state legislatures across the country have erected new barriers to prevent injured consumers from obtaining justice in the courts. We now have a government that responds more to the greed motive of corporate leaders than to the legitimate needs of people. The system is rigged in favor of the business elite. And the public is mad.

I am amazed by the breadth and depth of the corporate corruption now being unraveled. But I am not surprised. Unfortunately, the weak financial regulatory system that has failed the American people is only one piece of deregulation. We have also seen politicians of both parties rush to assuage their campaign contributors by whittling away vital health, safety and environmental protections at the behest of powerful corporate entities that fill their campaign coffers.

Corporate leaders remind me of Chicken Little. The sky is always falling. Seldom is there a new regulatory proposal that does not elicit howls of protests, typically characterized by complaints that new consumer safeguards will harm the economy or U.S competitiveness. These complaints typically prove fallacious.

We should remember that government regulations do not just drop from the sky without warning. They are almost universally based on real societal needs, as demonstrated by deaths and injuries from faulty products and workplace hazards, devastated ecosystems, polluted groundwater, unhealthy air, and rivers laden with PCBs and other toxic chemicals. Years of research, analysis and public debate precedes the final implementation of most rules. In the 1960s, for example, we lobbied for the first regulations to cover the safety of automobiles. The automobile companies fought back furiously. Today, as a direct result of improving automobile designs, cars and trucks are vastly safer. In 1966, there were 5.5 fatalities for every hundred million miles traveled by the American public By 2000, that ratio had dropped to 1.5 – a remarkable difference. Despite their dire warnings, the automobile companies are still in business and still making lots of money.

There are many, many more examples. So many, in fact, that Americans now take these safeguards for granted. They know the air is healthier than it was in the 1960s. They know rivers, lakes and bays are cleaner. They know that many unsafe pharmaceutical drugs and other products have been taken off the market, yet corporate America continues to peddle its siren's song – that government regulation is the enemy of free enterprise and profits. And their revolving-door lobbyists are able to make headway because the road is paved with the gold of massive campaign contributions.

This campaign money buys more than access. It buys policy. How else can one explain the incredible deference paid by this Congress to the pharmaceutical industry? This industry, in the current election cycle alone, has given more than $10 million in unregulated soft money to politicians of both major parties. This industry spent obscene amounts of money on lobbying in 2001 – $78 million – according to a recent Public Citizen report, and employed 623 lobbyists – more than one for every member of Congress. This money has stymied efforts to enact a meaningful prescription drug plan under the Medicare program.

Another example is the nuclear industry, which just won passage of legislation to build a massive nuclear waste dump at Yucca Mountain, Nevada, requiring the transportation of 77,000 tons of high-level nuclear waste through major population centers by truck, train and barge over 30 years. Since 1997, the nuclear industry has contributed more than $30 million in individual, PAC and soft money donations to federal candidates and parties, 68 percent of which went to Republicans. Why do they give this money if not to influence policy? And how can anyone justify making government decisions based on campaign money?

The point is that corporate America exercises far too much control over what passes – or doesn't pass – through the Congress. It is time for corporate rule to end. We must restore integrity to our business entities and to the political process To do that, the Congress and the White House must stand up to the corporate lobbyists and start legislating and governing on behalf of the American people. We need strong regulation of corporations – standards that will prevent wrongdoing and then punish executives who violate the public trust.

ARMY SECRETARY THOMAS WHITE

President Bush, who recruited his top government officials liberally from the corporate boardrooms, is talking tough about accountability for corporate leaders. But does he mean it? I would like to read a quotation about corporate accountability for CEOs from Treasury Secretary Paul O'Neill, from the July 11 edition of USA Today: "Whatever happens in your organization, you're responsible for it. There aren't any excuses for you to say, 'I didn't know. I didn't understand.' "

I agree wholeheartedly with Secretary O'Neill To meet this standard of conduct, and to begin restoring his credibility on this issue with the American public, President Bush should immediately relieve Army Secretary Thomas White of his duties Mr. White is the poster boy for corporate abuse. But instead of being held accountable, he now has his hand on the Army's massive budget.

Before being appointed to his position, Mr. White headed a subsidiary of the infamous Enron Corp. that blatantly manipulated the energy market in California to cause an artificial shortage of electricity, lied to state officials and cheated hard-working consumers out of literally millions upon millions of dollars with intricate schemes designed to rig the energy-trading markets and unfairly inflate company profits According to numerous sources, his division also employed the same type of questionable accounting measures that have defrauded investors and enriched corporate insiders at other companies.

Let me review the publicly available facts surrounding Mr. White's tenure at Enron. Up until the day he was nominated by President Bush and confirmed by the Senate in May 2001 to serve as Secretary of the Army, Thomas White was a high-ranking executive at Enron, where he had worked for 11 years. Since 1998, Mr. White served as vice chairman of Enron Energy Services, a retail services and wholesale energy trading subsidiary of Enron. As vice chairman, White shared oversight of the division's responsibilities with Lou Pai.

As vice chairman, he was in charge of negotiating many of Enron's retail energy contracts. During his tenure, Enron Energy Services became one of Enron's fastest-growing subsidiaries through the use of questionable accounting practices. Enron Energy Services' revenues climbed 330 percent to more than $4.6 billion in 2000 – up from $1 billion when Mr. White became vice chairman in 1998. Much of this revenue increase is attributable to aggressive accounting techniques, including so-called "mark-to-market" bookkeeping, under which Enron booked much of the long-term retail contracts' revenue immediately – providing the company with inflated revenues.

For example, in February 2001, Mr. White played a role in the high-profile signing of a retail energy services contract with Eli Lily. Enron claimed it was a 15-year deal worth $1.3 billion, but the details of the contract show that Enron paid Eli Lily $50 million up front as an enticement to sign the deal. Former employees of the division allege White's division used questionable accounting practices to create illusory earnings. Using "mark-to-market" accounting, Enron Energy Services would, for example, estimate that the price of electricity would fall over the life of a contract, and the unit would book an immediate profit on the contract.

Glenn Dickson, an Enron Energy Services director laid off in December, claimed that both Mr. White and Mr. Pai "are definitely responsible for the fact that we sold huge contracts with little thought as to how we were going to manage the risk or deliver the service."

While Enron Energy Services' reputation on Wall Street was as a retail supplier of energy, the division also was one of Enron's four registered power marketers, trading substantial amounts of energy in deregulated wholesale markets during Mr. White's tenure. According to internal Enron memos obtained by the Federal Energy Regulatory Commission and released in May, Mr. White's division played a key role in manipulating the West Coast energy market from May 2000 until the day he left in June 2001. Enron Energy Services colluded with other Enron divisions to deceive operators of California's energy grid into believing that transmission capacity was full. In the first three months of 2001 – at the height of skyrocketing prices and

rolling blackouts – this division traded more than 11 million megawatts of electricity in the California market alone, making nearly 98 percent of these trades with other Enron divisions at astronomical prices up to $2,500 per megawatt hour.

This type of manipulation scheme was damaging because it led California officials to believe that transmission lines were clogged, and so power was intentionally shut off to millions of Californians. Meanwhile, Enron was able to profit by getting the state to pay Enron for relieving congestion on transmission lines This naked profiteering and fraudulent activity by Enron caused a massive disruption in the economy of California and the lives of citizens there. Electricity rates soared. Small businesses suffered. Rolling blackouts cut power to millions Pacific Gas and Electric, California's largest investor-owned utility, was victimized by exorbitant wholesale rates that it could not recover and sought bankruptcy protection in April 2001. California Edison also went deeply into debt, but has not filed for bankruptcy. The state of California was forced in January 2001 to begin spending billions of dollars to purchase power for its residents

Regulators found it difficult to trace Enron's trades because the company had four separate divisions interacting in the wholesale and retail markets, and with each other, with little transparency. These practices also allowed various Enron units to overstate revenues and contributed to the accounting gimmickry that artificially inflated the company's share prices.

While it is unclear as to whether or not Mr. White personally knew all of the details of these fraudulent trading practices, it is very clear that he profited from them.

When President Bush nominated Mr. White for the post, he cited his experience as a top Enron executive as a primary qualification. Mr. White made tens of millions of dollars during his tenure at Enron. In 2001 alone, he was paid $5.5 million in performance-based salary and he sold $12.1 million in Enron stock just before the company collapsed in December 2001. Last year Mr. White owned three opulent homes and condos, with a total value of more than $16 million.

And just like President Bush, Mr. White had a problem reporting some of these stock sales to the Securities and Exchange Commission, as required by law. Here is an excerpt from page 29 of a Schedule 14a filed by Enron with the SEC on March 27, 1995: "Section 16(a) of the Securities Exchange Act of 1934 requires Enron's executive officers and directors, and persons who own more than 10% of a registered class of Enron's equity securities, to file reports of ownership and changes in ownership with the SEC and the New York Stock Exchange. Based solely on its review of the copies of such reports received by it, or written representations from certain reporting persons that no Forms 5 were required for those persons, Enron believes that during 1994, its executive officers, directors and greater than ten percent stockholders [sic] complied with all applicable filing requirements, except that Thomas E. White failed to timely file one report for one transaction "

In addition, Mr. White has been habitually late in reporting to Senators when asked to disclose his Enron holdings after being named Army Secretary. He agreed to divest all of his Enron holdings within 90 days. He subsequently received at least two extensions from the Senate Armed Services Committee But he was reprimanded by the leadership of the Committee when members learned that he continued to hold a large chunk of Enron stock options into January 2001 and had failed to inform them that he had accepted a pension partly paid by Enron.

Mr White's ethical lapses continued, when in March 2002, he flew on an Army jet with his wife at taxpayer expense to Aspen, Colorado, to sign the papers on the sale of a $6.5 million estate.

While at Enron, Mr. White became a very wealthy man. What was the purpose of his compensation? If he is not accountable for what went on in his company, then why was he paid these millions? Was it because of his business acumen? Was it because of his connections to the Defense Department at a time when Enron was trying to win military contracts? The bottom line is that if Mr. White knew what was going on with Enron Energy Services, he has no business running the Army. If he did not know, he is an incompetent manager and therefore should resign his post.

President Bush has appointed many others from the corporate boardrooms, giving Americans the sense that the foxes are indeed guarding the henhouse. No wonder the stock market has been plunging since the

president gave a tepid speech on Wall Street last week The former lawyer and chief lobbyist for the Big Five accounting firms, who opposes the Sarbanes bill's independent accounting standards board, now heads the Securities and Exchange Commission. And Deputy Attorney General Larry D. Thompson, the president's choice to lead his new corporate fraud task force, used to sit on the board of Providian Financial Corp., a credit card company that paid more than $400 million to settle allegations of consumer and securities fraud. Mr Thompson, according to the Washington Post, sold stock worth nearly $5 million just a few months before Providian began to disclose business problems that led to a collapse in the company's stock price. That is the same pattern that we have seen with other corporate scandals. President Bush himself, as well as Vice President Dick Cheney, also have been implicated in possible accounting irregularities and stock sales that preceded sharp drops in stock prices.

We are not inspired by President Bush's recent call for $100 million to be added to the SEC's budget, after he earlier sought to slash the agency's budget. Under Bush's recommendation, the SEC would have a budget of $513 million, a pittance compared to the Drug Enforcement Agency's budget of $1.8 billion. Much more is needed. And we should examine the penalties meted out to white-collar criminals. The average sentence for white-collar criminals is less than 36 months. By comparison, non-violent, first-time federal drug offenders get an average sentence of more than 64 months.

We hope that President Bush is serious about putting corporate criminals in jail. But the government's record over the past 10 years is not good. The SEC has referred 609 offenders to the Justice Department for criminal prosecution. Of those, 187 were faced criminal charges, and only 87 went to jail.

INCENTIVES TO COOK THE BOOKS

Fortunately, the Senate on July 15 passed legislation to begin addressing these corporate abuses. Most unfortunately, the measure, the Sarbanes bill does nothing to help defrauded investors. But Public Citizen strongly endorses it as an important step because it: (1) begins to put an end to the failed self-regulation of the accounting industry by establishing an independent Public Company Accounting Oversight Board to monitor the accounting industry; (2) forbids some – but not all – non-auditing services performed by accounting firms that are simultaneously providing auditing services (although the Senate bill allows for case-by-case exemptions); (3) promotes a "fresh pair of eyes" by forcing accounting firms to rotate the lead accounting partners (but not accounting firms) on audits after five years; (4) addresses revolving-door conflicts of interest by prohibiting accounting firms from auditing companies whose top executives worked for the firm during the year before the audit, (5) strengthens the Financial Standards Accounting Board and gives it more independence from the industry; (6) requires CEOs and CFOs of public companies to personally vouch for the accuracy of financial reporting; (7) requires disclosure of insider stock trading within two days; (8) prevents executives from selling stock during employee stock sale blackout periods; (9) financially penalizes executives for earnings restatements; (10) restricts loans to executives; and (11) makes securities fraud a criminal offense and increases prison sentences for fraud

It is unfortunate that the bill does not address one of the major underlying incentives that have prompted crooked executives and accountants to cook the books – the practice of granting stock options. The common thread woven through virtually all of the ongoing corporate scandals is the fact that executives were granted exorbitant stock options. Corporate boards have handed out stock options like candy, and they are not required to count them as an expense on their balance sheet, even though they dilute shareholder equity as surely as if the payments were made in cash. Because corporations do not have to account for these expenses, they have become an insider scheme to enrich executives. Though they were once believed to align the interests of management with shareholders, perversely, the opposite has occurred. As we've learned from Enron and other companies like Global Crossing, WorldCom and Qwest, the allure of stock options can drive executives to intentionally distort the numbers to create temporary run-ups in stock prices so they can cash out quickly, while investors are left to soak up the losses.

Research shows that more and more corporations are turning larger shares of their earnings over to insiders by increasing the number of stock options issued to executives and directors. At Enron, for example, Ken Lay exercised $180.3 million in stock options from 1998 to 2000, and Jeffrey Skilling cashed in $111.7 million in options.

"Stock option overhang" is a measure of the number of stock options granted to employees and directors (both the number already issued and the number of options promised in the near future) compared to the

total number of shares held by investors and employees. This measure can estimate the potential of investors' shares to be diluted by stock options policy. Many institutional investors, such as large pension funds, don't want a stock option overhang to exceed 10 percent of shares outstanding. A February 2002 survey by the Investor Responsibility Research Center showed that the stock option overhang for the S&P 500 was 14.3 percent And 13 of the 50 largest U.S. corporations had a stock option overhang that exceeded 14 3 percent J.P Morgan Chase, for example, had an option overhang of more than 20 percent. Morgan Stanley was one of the highest at 36 percent.

Another way to measure the potential negative impact of stock options is the "stock option run rate." This adds up the stock options granted over the past three years, divides by three, and then divides by the total number of shares held by all investors and employees. Many experts agree that a stock option run rate exceeding 1 percent is excessively diluting investors' equity. Two hundred of the largest U.S. companies have stock option run rates of 2.6 percent, more than double the rate of a decade ago (1.08 percent in 1991), according to compensation consultants Pearl Meyer & Partners. Although a stock option run rate of 3 percent may look small at first glance, if these current scandals return the market to its historical 10 percent annual rate of return, that would mean a company with a stock option run rate of 3 percent would see one-third of the company's value siphoned off by the time the stock options expire in 10 years.

It's also important to note the share of all stock options enjoyed by the top executive. A CEO holding more than 5 percent of all stock options should be considered excessive. So what to think about the CEO of Freddie Mac (10.9 percent), American International Group (10.6 percent), Fannie Mae (7.4 percent) and Wells Fargo (5.6 percent)?

This is a scam on investors. Companies are currently allowed to deduct these stock options as an expense in figuring their tax liabilities – but are not required to do so in reporting profits or losses to shareholders. Companies would not be so free in handing out so many options if they were counted as an expense. Plus, there should be requirements for executives to hold stock options for the long-term – not cash in during stock price spikes or shortly before the company announces bad news.

On July 16, the International Accounting Standards Board announced a unanimous decision to require that executive stock options be counted as a business expense by 2005 in the EU and Australia. The U.S. legislation should be identical.

Another common thread in the scandals is the practice by accounting firms of providing consulting services at the same time they are auditing the finances of corporations. Accounting firms that collect large consulting fees from the corporations they audit have a strong incentive to look the other way when corporations cook the books. In essence, the auditors are in part auditing their own company's work. The big accounting firms, which are supposed to audit the books of public corporations and certify to the board, public and investors that they accurately portray a company's financial status, have been seduced and corrupted by multimillion-dollar consulting services that they also provide to the same companies they are auditing. This creates an enormous and unconscionable conflict of interest that leads to the type of abuses we have seen in Enron, WorldCom, Tyco, Halliburton, Global Crossing, Adelphia, Xerox and others. The previous head of the SEC, Arthur Levitt, sought to end this conflict, but in the deregulatory climate of the 1990s, his proposal was quashed And now working Americans are paying a severe price.

While S 2673, the Public Company Accounting Reform and Investor Protection Act of 2002, does address these conflicts of interest by banning certain types of consulting contracts, it still allows many damaging consulting services – such as providing tax shelter advice – to be performed by companies that are in charge of audits

Submitted with my testimony today is a new study by Public Citizen of these fees (see Appendix A and B) Public Citizen found that the 20 largest companies in the United States all had consulting relationships with their accounting firms in 2000 and 2001 that, at the very least, created incentives for cheating. In the aggregate, 72 percent of the $880 million in fees paid by these Fortune 500 companies to their accountants in 2001 were for consulting services – meaning that at the same time accounting companies were supposed to be looking out for shareholders, they were also helping their clients develop accounting schemes to hide income from taxation, or conceal debt and revenues from regulators and investors.

Some examples from the year 2001: AT&T paid $78 million to PricewaterhouseCoopers, 86 percent of which

went for non-audit services. ExxonMobil paid $87 million to PricewaterhouseCoopers, 80 percent for non-audit services. General Motors paid $102 million to Deloitte & Touche, 79 percent for non-audit services Chevron paid $64 million to PricewaterhouseCoopers, 83 percent for non-audit services. Duke Energy paid $15 million to Deloitte & Touche, 78 percent for non-audit services. Bank of America paid $74 million to PricewaterhouseCoopers, 81 percent for non-audit services.

We also looked at corporations whose practices have come under recent scrutiny. Enron was one of the best. It paid $52 million to Arthur Anderson in 2000, a mere 52 percent for non-audit services. The highest percentage we found was for BristolMyersSquibb, which in 2001 paid $41 million to PricewaterhouseCoopers, 93 percent for non-audit services. Halliburton in 2001 paid $27 million to Arthur Anderson, 73 percent for non-audit services. The year before, Halliburton paid $52 million to the company, 86 percent for non-audit services. Global Crossing in 2000 paid $14 million to Arthur Anderson, 84 percent for non-audit services. Tyco paid $35 million in 2001 to PricewaterhouseCoopers, 62 percent for non-audit services. WorldCom paid $17 million to Arthur Anderson in 2001, 74 percent for non-audit services.

How can this possibly be justified? Unless accountants are completely banned from providing both auditing and consulting services simultaneously to the same client, these conflicts of interest will continue to plague the industry.

In addition to these regulatory failures dealing with stock options and accounting rules, the rights of investors to protect themselves and recover for losses due to fraud have been severely curtailed by Congress and the U.S. Supreme Court. This has allowed corporate criminals to swindle investors with the knowledge that there was little they could do in return.

LAWS PROTECTING INVESTORS' RIGHTS ARE WEAKENED

In the 1980s, a key target of this business attack on laws punishing financial fraud was the civil RICO (Racketeer Influenced and Corrupt Organizations Act) law Amazingly, this onslaught was initiated in the midst of the revelations of self-dealing, insider trading and fraud by the savings-and-loan thieves. The scandal put a public face on this arcane but potent law. For a number of years, Public Citizen fought tooth-and-nail against the accounting industry lobbyists, who liberally lathered both Democratic and Republican members of Congress with campaign money to obliterate this very effective law prohibiting conspiracy to defraud with its important attorney fees and treble damages for the victims. Without the determination and persistence of Senator Howard Metzenbaum, we would not have succeeded in stopping this corporate juggernaut. Without civil RICO, the bondholders in the Charles Keating S&L fraud would not have been fully compensated. The S&Ls and accounting firms paid out some $1.4 billion in damages for their fraudulent practices

In the 1990s, two key Supreme Court cases were decided by 5-to-4 votes, and after the Republicans took over the Congress in 1995, three key pieces of legislation were enacted, the first one over President Clinton's veto, that, together, have taken the federal, state and investor cops off the corporate crime beat and have left many securities fraud victims without a remedy. At the same time, the funding of the Securities and Exchange Commission was not increased as the financial markets grew exponentially. Predictably, a business ethics gap matured into full flower, and we are now experiencing a corporate crime wave of untold proportions that is undermining public trust in our markets and robbing citizens of their pensions and life savings and kids of their college tuition nest eggs. Not surprisingly, the accounting industry gave liberally to members of Congress from both parties. From 1990 to 2002, this industry gave almost $57 million dollars in campaign money, $24 million to Democrats and $33 million to Republicans.

In 1991, the U.S. Supreme Court in *Lampf, Pleva* limited the federal statute of limitations to one year from the discovery of securities fraud or three years from the violation, whichever is earlier, shortening the time that was allowed under federal law previously, when courts borrowed the generally longer state law limitation periods. In 1994, in the *Central Bank* case, the Court came down with a strict construction decision, holding that those engaged in "aiding and abetting" are not liable in consumer or investor federal securities fraud cases because these words are not specifically in the statute. Aiding and abetting had been universally recognized as a federal violation for 60 years since the enactment of the federal securities laws and was accepted in every federal circuit. The S&L scandal could not have been perpetrated without the active and knowing assistance of numerous professionals, particularly lawyers and accountants. By allowing these professionals to escape liability, this decision undercut recovery by the victims and diminished the incentive

to exercise due care and prevent reckless or knowing misconduct in assisting in the perpetration of a fraud in violation of federal securities laws. Needless to say, Vinson & Elkins and Kirkland & Ellis – Enron's lawyers – have cited *Central Bank* in recent motions to dismiss shareholder litigation. We all know the power of corrupt lawyers and accountants. They are the engines that drives corporate fraud. They must be held accountable.

In 1995, following a massive lobbying campaign, Congress passed the Private Securities Litigation Reform Act over President Clinton's veto. It was promoted as necessary to stop so-called "frivolous" lawsuits, even though investor lawsuits had barely increased in the seven years prior to its enactment. But it was a nuclear bomb used to quash an ant hill. The act for the first time radically diluted laws against making false earnings projections (sound familiar today?). By rejecting an amendment to overrule the *Central Bank* decision, it also gave protection to accounting firms that approved false earnings statements, such as those issued by Arthur Andersen for Enron's massive deception. It granted companies and their accountants "safe harbor" protections, which Public Citizen criticized at the time. Thus accountants who failed to spot or disclose fraud could be given immunity from private lawsuits, as were companies issuing false earnings projections, even if they lied.

The act also forced defrauded investors to meet a high pleading standard with respect to a corporate officer's state of mind (generally only required in criminal cases); stayed discovery proceedings until the defendant's motion to dismiss is decided, thus preventing fraud victims from obtaining the very evidence needed to defeat the motion; for the first time limited liability of auditors and other conspirators from full accountability under "joint and several liability"; failed to extend the statute of limitations imposed by the Supreme Court; eliminated treble damages as punishment for deliberate fraud under civil RICO; failed to restore private liability for aiding and abetting securities fraud, and for the first time required plaintiffs to divulge in the complaint any confidential sources, thus preventing fraud victims from gathering key evidence from confidential informants such as whistleblowers, employees, ex-employees, competitors and media.

The absence of these protections is directly related to the corporate fraud and failures we have been witnessing with dismay day after day. A securities fraud case against MCI WorldCom was dismissed earlier this year because, among other things, the court found that the plaintiff's complaint "does not attain the heightened pleading standard requirements for this type of case" under the 1995 law. The case alleged that the company and its top executives had "cooked the books" and fraudulently misled investors by artificially inflating the financial condition of the company, but the court found that there were not enough facts showing CEO Bernard Ebbers had acted with "actual knowledge or conscious misbehavior."

Also, a 1999 securities fraud case against Tyco International Ltd. was thrown out because of the 1995 law. It was filed after reports of spectacular earnings increases and huge stock sales by executives and directors, including Chairman and CEO Dennis Kozlowski, who sold $187 million in stock, Director Michael Ashcroft, who sold $37.4 million, and General Counsel Mark Belnick, who sold $7.6 million. There was a total of $252.8 in insider stock sales. Tyco then "restated" its financial statements after a limited SEC review. After two years of attempting to meet the harsh pleading standards of the 1995 law, the investors' action was dismissed by the court Today, top executives are fired, indicted or under investigation, and many walked away with millions of dollars. The investors have not recovered their losses and the shortened statute of limitations has run. As the Washington Post headlined on July 17, 2002, "The Shareholder Lawsuit: A Red Flag for Auditors," these lawsuits serve a multitude of purposes – compensation for victims, deterrence and notice to auditors, the board and government enforcers.

Not satisfied with these cutbacks severely limiting the possibility of recovery by victims of securities fraud, the Congress in 1996 enacted the National Securities Markets Improvements Act, which preempted much state regulation of securities transactions. Again in 1998, the Congress cut back investor protection. It passed the Securities Litigation Uniform Standards Act, which forced virtually all securities fraud class action lawsuits to be tried in federal courts under the weakened federal law, taking away stronger protection for small investors under tougher state class action laws, such as longer statute of limitations, aiding and abetting liability, and joint and several liability.

At the same time, the independent Securities and Exchange Commission under Chairman Arthur Levitt was trying to change SEC rules to eliminate conflicts in the accounting companies by separating auditing and consulting services. The number of financial fraud cases, in Levitt's words, "absolutely exploded." Three big accounting firms — Arthur Andersen, Deloitte and KPMG – said, in Levitt's words, "We're going to war with you. This will kill our business. We're going to fight you tooth and nail. And we'll fight you in the Congress and

we'll fight you in the courts."

Sure enough, Levitt shortly thereafter received a demand letter from three top chairmen on the House Commerce Committee: Tom Bliley, Mike Oxley and Billy Tauzin, making 16 demands for extensive information that tied the agency up for weeks and in Levitt's words "intended to really stand in the way of the rulemaking we had in mind " Levitt has described how the heat was kept up with "telephone calls, congressional hearings, and ultimately by threatening the funding of the agency ... threatening its very existence." He was also threatened with a rider on his appropriations bill if he proceeded. Another letter came from Senate Banking Committee members Rod Grams, Evan Bayh, Phil Gramm, Charles Schumer, Mike Crapo, Rick Santorum, Chuck Hagel, Jim Bunning, Wayne Allard and Robert Bennett, opposing auditor independence rulemaking After being urged again by many members of Congress to make peace with the audit companies, Levitt agreed to a compromise rule that just called for corporations to bring to their Boards' audit committees any consulting contracts that they had made with their auditor. At Enron, Wendy Gramm, former chair of the Commodity Futures Trading Commission, sat on the audit committee.

As if these laws and court decisions had not harmed investors enough, now securities firms are using mandatory arbitration agreements to force aggrieved investors into a company's own, costly private judicial system, where there is limited discovery, limited recovery and where arbitrators must depend on the defendants for repeat business.

I recently received a letter from a member of Public Citizen who wrote that he opened an investment account with Payne Webber and was required to sign a statement agreeing to arbitration in the event of a dispute with the company. He did this only after researching virtually every stock broker in the country and finding that he could not buy stocks without agreeing to arbitration. "This is a tragedy," he wrote.

One more way that corporate America has put the screws to the people without whom it could not survive.

PUBLIC UTILITY HOLDING COMPANY ACT

Particularly relevant to the fraudulent dealing and manipulation at Enron in which Army Secretary Thomas White participated is deregulation as it applies to energy policy. Despite the California electricity scandals, the unraveling of the stock market and almost daily revelations of new corporate abuses, we continue to see a drive to deregulate business – even in the energy sector. There is a provision in the recently passed energy legislation that will have a devastating impact on consumers and lead to more Enron-style abuses. On April 25, the Senate voted to repeal the Public Utility Holding Company Act (PUHCA). This vote to repeal PUHCA comes at a time when courts are finally using the law to rescue consumers. At a time when the Enron disaster and the failure of electricity deregulation across the country (a dozen states have repealed or delayed their deregulation laws) illustrate how vulnerable consumers and investors are to impenetrable corporate structures and unaccountable markets, PUHCA's protections are needed now more than ever.

PUHCA was enacted in 1935 in response to the United States' first Enron-style energy crisis in the 1920s. A handful of energy companies, employing business strategies strikingly similar to Enron's, held consumers hostage with complex, multi-state pyramiding schemes. These holding companies purchased financial, fuel and construction businesses through a complex web of subsidiaries. Not only did consumers pay inflated prices for energy to fuel the acquisition and operations of businesses unrelated to the core energy concerns, but investors were robbed because the holding company's assets were artificially inflated. These pyramiding schemes finally collapsed, ringing in the stock market crash of 1929 and the Great Depression.

The Securities and Exchange Commission is supposed to enforce PUHCA, which protects consumers by ensuring that multi-state utility companies re-invest ratepayer money into providing affordable and reliable electricity. A corporation must register as a "holding company" if it owns at least 10 percent of the stock of an electric or natural gas utility. Consumers benefit from PUHCA's requirements that holding companies invest only in "integrated systems" – utilities that are "physically interconnected" – thereby maximizing economies of scale by operating a single, coordinated system. PUHCA has historically prohibited holding companies from investing ratepayers' money in areas that will not directly contribute to low bills and reliable service, such as out-of-region power plants or non-electricity industries such as water and telecommunications.

PUHCA is the most important protection the federal government provides for electricity consumers. But the

law's potency has been eroded over the past decade. Enron, with help from regulators and Congress, helped undermine the act's effectiveness by creating new loopholes. Incredibly, rather than proposing to close these Enron exemptions to prevent other energy companies from abusing consumers and investors, the response by the Bush Administration and Congress (including the Senate Democrat energy bill) is to repeal the entire law. Repealing PUHCA will lead to a rash of mergers, further threatening consumers.

PUHCA has lost much of its teeth as a result of deregulation, Enron's lobbying, and decisions by the SEC to simply ignore the law. First, Congress undermined PUHCA by passing the 1992 Energy Policy Act, permitting holding companies to invest ratepayer money in foreign power projects and divert resources away from American consumers Second, Enron pushed a gaping hole in SEC regulation when the SEC, in response to a petition by the company, exempted power marketers like Enron from PUHCA on Jan. 5, 1994. As a result, power marketers – creatures of deregulation that don't own power plants but rather speculate on and trade electricity contracts – can trade free from government oversight in deregulated markets across the country. Finally, the SEC has refused to enforce the investment provisions of PUHCA, instead rubber-stamping mergers that are in direct violation of PUHCA's consumer protections – including the foreign acquisition of several U S. utilities.

These loopholes have already resulted in a significant increase in utility consolidation. In 1992 (prior to the passage of the loophole-creating Energy Policy Act) the 10 largest utilities owned one-third of the national generating capacity. By 2000, the top 10 owned half of all capacity, while the top 20 owned 75 percent. These numbers will become more concentrated if PUHCA is repealed, inevitably resulting in monopoly pricing.

Although proponents of repealing PUHCA claim that the law's ownership restrictions hinder adequate investment, corporate leaders appear to be more interested in repealing PUHCA to satisfy their craving for Enron-style accounting freedom and convergence. If PUHCA is repealed, a flurry of mergers will bury our electricity markets, rendering states incapable of regulating sprawling multi-state holding companies. The already overwhelmed Federal Energy Regulatory Commission (FERC) will face a daunting task in trying to regulate all energy markets Both Democrats and Republicans propose replacing PUHCA's consumer protections with weaker ones that would be under the jurisdiction of FERC, which the GAO recently concluded was deficient in handling its current responsibilities. But these huge holding companies will have incentive to cover their tracks with Enron-esque accounting, and no state or federal agency will be able to verify the accuracy of the bookkeeping.

Enron's collapse exposed consumers and investors to the dangers of inadequate government oversight inherent in electricity deregulation. The combination of deregulated state wholesale electricity markets, federal deregulation of commodity exchanges and the creation of loopholes in PUHCA removed accountability and transparency from the energy sector. Had PUHCA's loopholes been closed and the law properly enforced, Enron's fraud against shareholders and consumers never could have occurred! PUHCA's ownership limits would have prevented the company from hiding revenues and debts in offshore tax havens and failed foreign projects, such as Enron's Dabhol power plant in India.

The solution is to strengthen PUHCA rather than repeal it. First, Congress must require the SEC to strictly enforce the act, and beef up funding and staff for the SEC. Second, the harmful loopholes pushed through by Enron and other energy companies must be closed. Holding companies must no longer be allowed to divert funds secured from consumers for this essential commodity to invest in foreign countries, and power marketers must be subject to PUHCA. Third, Congress can improve PUHCA by using it to address issues of market power. For example, Congress should grant federal and state regulators the authority to order holding companies to divest assets, expand anti-trust investigations and enforcement, and create non-profit, consumer-owned regional transmission councils to ensure non-discriminatory access to the grid.

It is important to note a recent court decision that could require the SEC to enforce PUHCA In January 2002, the U.S. Court of Appeals for the District of Columbia ordered the SEC to revisit its decision to approve a merger between American Electric Power (AEP) and Central & South West (CSW). Public Citizen had maintained that the SEC's earlier decision to approve this merger between Ohio-based AEP and Texas-based CSW violated PUHCA's requirements that holding companies have interconnected systems. The SEC had ruled that because the two utilities are connected by a lone, 250-mile transmission line owned by an unrelated company that the merger satisfied PUHCA! The judge's decision illustrates that the court has finally noticed that the SEC has refused to enforce the law and will force the review of other recently approved

mergers that clearly violate PUHCA (Progress Energy, a union between Florida Progress and Carolina Power & Light, Exelon, a product of PECO Energy and Unicom, Xcel, a merger between Northern States Power and Public Service Co., and the foreign acquisition of Oregon-based Pacificorp by Scottish Power).

REMEDIES

The public is paying a dear price for the follies of the 1990s. The dreams and hopes of tens of millions of families across America are being dashed by the misbehavior of unethical companies spurred by greed. The Congress has permitted this disaster, and we are pleased to see it taking some corrective action. We support the new corporate accountability requirements contained in the Sarbanes bill but believe Congress must go further to protect consumers, investors and employees of corporations. We applaud the criminal penalties it contains They should apply as well to knowingly selling defective products that kill or injure.

One critical ingredient that is still missing is the ability of investors to recover damages when regulators fail to prevent harm. We all know that regulations alone are not sufficient to deter wrongdoing. Federal agencies are often underfunded and are sometimes poorly managed. Congress and several court decisions have undercut the ability of citizens to seek proper justice in the courts These rights must be restored.

In addition, there are key consumer protections contained in the Public Utility Holding Company Act, which is repealed in the Senate's energy legislation This law has been weakened in piecemeal fashion by a lack of enforcement and Congressional actions. It should remain on the books, be improved and be enforced vigorously. Finally, even with the Sarbanes bill, there remain problems with corporate governance and possible conflicts of interest in the accounting industry.

The following are Public Citizen's specific recommendations:

Investor Recovery for Fraud

- The two Supreme Court decisions and the three statutes cutting back liability to investors for corporate fraud must be changed, as I have testified. Professionals, including accountants and attorneys, must be liable for aiding and abetting. And the statutes of limitation must be longer, as provided in the Sarbanes bill, given the difficulty of learning the truth about fraudulent activity.

- The Private Securities Litigation Reform Act must be largely repealed to give investors a level playing field in their efforts to recover against corporate giants who control all the information about any financial misbehavior. And federal laws should not limit state regulation or state courts from protecting investors merely because some states have more progressive laws than the existing federal law. Further, securities firms should not be allowed to impose their own private legal system of mandatory predispute arbitration that prohibits court adjudication of disputes. If companies know there is a strong likelihood of federal or state government or private enforcement, they will be far more likely to behave.

- Gag orders in the settlement of litigation, often demanded by corporations, must be prohibited if they would result in covering up corporate fraud against investors.

Restoring strong regulation to energy markets

- Do not repeal the Public Utility Holding Company Act in the pending energy bill.

- Re-regulate energy trading. Pass Senator Feinstein's bill, which would restore accountability in energy markets by overturning the 1993 decision to not extend CFTC jurisdiction over energy trading contracts and the Commodity Futures Modernization Act of 2000 (which deregulated over-the-counter energy trading), allowing companies like Enron to operate unregulated power auctions.
- Strengthen the regulatory and enforcement power of the Securities and Exchange Commission by extending jurisdiction over power marketers

- Amend the Federal Power Act, forcing the Federal Energy Regulatory Commission to revoke market-based rates and order cost-based pricing in all wholesale electricity markets.

Corporate Executive Obligations and Limits

- First and foremost, stock options must be treated as an expense by corporations, as Senator McCain has so effectively argued. Overuse of options has distorted the financial markets, diluted shareholder value, and encouraged greedy executives to manipulate corporate books to drive stock prices higher in the short term at the expense of long-term stability and financial health If options are exercised, as Senator McCain suggests, the net gain after taxes should be held in company stock until 90 days after departure from the company

- Repricing or swapping of stock options for executives must be prohibited (Business Week reports that 200 companies regularly did this for the corporate elite).

- Top executives and board members should be prohibited from selling company stock while still employed or serving there.

- Company loans to corporate officers or directors must be prohibited. (412 of 1,000 U.S. companies lent money to top executives, often at low interest rates, from 1991 to 2000 – almost double the number from the prior decade)

- Executives must return all compensation, as Senators Dorgan and McCain have urged, that is directly derived from proven misconduct While the SEC already has authority to require disgorgement of ill-gotten gains, in 2002 it has requested it in only four cases out of hundreds of "restatements" and dozens of investigations of accounting failures.

Auditor Responsibility

- The Sarbanes bill properly requires auditors to report to the Board (which is supposed to represent shareholders, not be handmaidens to management) The bill limits auditors from providing many consulting services and requires preapproval by the Board audit committee where allowed. Consulting services by auditors should be completely prohibited.

- The Sarbanes bill requires the audit personnel to rotate every five years but does not require a new audit company. A new audit company is needed to take a fresh look at the company's books.

Corporate Governance

- The corporate compensation committee must be composed of board members with no personal relationship with management or special relationship with the company. The compensation, audit and nominating committees should be made up of only independent members.

- No more that two board members should be insiders.

- Directors should not serve on more than three boards.

- If shareholder resolutions pass by a majority of votes cast for three consecutive years they should be considered adopted.

- Shareholder meetings should be held in locations where the largest number of shareholders reside, not in remote locations where most cannot attend.

Securities and Exchange Commission

- In addition to increasing staffing and funding for the SEC, the SEC must ensure transparency of its actions and of reporting by companies in formats that enhance the ability of shareholders to evaluate this complex information

Pension Reform

- Limit the percentage of a company's stock that can go into a pension fund;
- Allow employees to move investments in pension plans from company stock to other securities (a right denied to Enron's unfortunate employees).
- Require employees to have equal representation on the 401(k) boards that oversee pension systems
- Require investment advisers to be independent, without ties to the company.

There are five attachments to my testimony: (A) a Public Citizen compilation of spending for accounting services – auditing versus non-auditing services – by corporations that have recently been implicated for questionable accounting, for the years 2000 and 2001; (B) a Public Citizen compilation of spending by the nation's 20 largest corporations on accounting services in 2000 and 2001 – auditing versus non-auditing services, (C) a copy of the April 17, 2000, letter from the leadership of the House Commerce Committee to then-SEC Chairman Arthur Levitt, referenced in my testimony; (D) a copy of a Sept. 20, 2000, letter from Enron CEO Ken Lay to then-SEC Chairman Arthur Levitt, commenting on the SEC's proposed rulemaking regarding auditor independence; and (E) a list of 50 thoughtful recommendations for stemming corporate abuses, taken from "Corporate Crime and Violence," a 1988 book written by Russell Mokhiber, who is the editor of the weekly newsletter Corporate Crime Reporter.

I would like to finish with a quote from the May 6, 2002, edition of Business Week. It says that "the challenge in coming years will be to create corporate cultures that encourage and reward integrity as much as creativity and entrepreneurship To do that, executives need to start at the top, becoming not only exemplary managers but also the moral compass for the company. CEOs must set the tone by publicly embracing the organization's values How? They need to be forthright in taking responsibility for shortcomings, whether an earnings shortfall, product failure, or a flawed strategy and show zero tolerance for those who fail to do the same."

Thank you very much.